No. 9735

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

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GEORGE D. MARTIN, as Internal Revenue Agent in Charge for the Sixth United States Internal Revenue Collection District of California,

*Appellant.*

*vs.*

CHANDIS SECURITIES COMPANY and H. E. DOWNING, as Assistant Secretary of Chandis Securities Company,

*Appellees.*

**Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.**

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## APPELLEES' CUMULATIVE BRIEF.

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## APPELLEES' CUMULATIVE BRIEF.

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### Prefatory Statement.

At the oral argument on February 24, 1942, the court on its own motion ordered the "Brief for the Appellant" stricken from the files and instructed appellant to file a further brief. There is now on file a "Second Brief for Appellant." On March 28, 1942, Judge Denman signed an order permitting appellees to file a new brief, which we have designated "Appellees' Cumulative Brief." This brief is in response to the Second Brief for Appellant. It embraces all of the matters considered in Appellees' Brief and in addition certain matters raised for the first time in the Second Brief for Appellant. It entirely supersedes Appellees' Brief.

## Statement of the Pleadings and Facts Disclosing the Basis of the Contended Jurisdictions.

### Jurisdiction of the District Court.

The pleadings and facts disclosing the basis upon which appellant contends the District Court had jurisdiction are stated in Second Brief for Appellant, pages 2-4. The statute relied on by appellant is Internal Revenue Code Sec. 3633.[1]

Jurisdiction of the District Court to issue the Order for Production of Records [R. 13] is considered (*post,* pp. 10 and 11.)

### Jurisdiction of This Court.

The pleadings and facts disclosing the basis upon which appellant contends this court has jurisdiction upon appeal to review the order granting the motion to quash the Order for Production of Records [R. 151] are stated in Second Brief for Appellant, pages 5-6. Jurisdiction is invoked under Sec. 128(a) of the *Judicial Code.*[2]

Jurisdiction of this court is considered (*post,* pp. 11 to 15).

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[1]Sec. 3633: "If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data."

[2]Sec. 128(a): "The Circuit Courts of Appeal shall have appellate jurisdiction to review by appeal final decisions—First. In the District Courts, in all cases save where a direct review of the decision may be had in the Supreme Court under Sec. 345 of this title." (28 U.S.C. Sec. 225.)

## Statement of the Case.

On Monday, March 16, 1931, Marian Otis Chandler (hereafter called "Mrs Chandler") filed her federal income tax return for the calendar year 1930 [R. 112]. Nearly nine years later (November 10, 1939) appellant served upon appellee Chandis Securities Company (hereafter called "Chandis") a letter from the Commissioner of Internal Revenue advising that a reinvestigation of its records for the years *1916 to 1930* was deemed necessary in order to verify its income tax returns for those fifteen years [R. 25, 37-38]. On November 28, 1939, Chandis by letter advised the Commissioner it would not permit the examination [R. 38]. On November 30, 1939, appellant issued and served two administrative summonses on Chandis—one pertaining to Mrs. Chandler's 1930 income tax [R. 10], the other to Chandis' income tax liability for the years 1916 to 1930 [R. 40]. Each summons required the production of substantially the same documents, namely, *all records of Chandis for the years 1916 to 1930* [R. 10, 40]. Appellees did not comply with either summons.

### Summary of Proceedings in the District Court.

Thereupon appellant petitioned the District Court for an order requiring the production of said records, assigning as his reason the desire to reinvestigate Mrs. Chandler's 1930 return [R. 2]. Appellant has never petitioned the court to compel production of these records in connection with his investigation of the returns of Chandis for the years 1916 to 1930. *But he is seeking, while ostensibly investigating Mrs. Chandler's return for one year, 1930, to examine Chandis' records for fifteen years!*

District Judge Yankwich on March 5, 1940, made an *ex parte* order, as prayed for by appellant [R. 13-16]. Thereafter appellees made timely motion to quash the order [R. 19], and on June 10, 1940, Judge Yankwich granted appellees' motion

> "* * * without prejudice, however, to a new application upon a new petition and a proper showing limited in point of time and 'to matters required to be included in the return' of Marian Otis Chandler, with special reference to the particular transaction which is under investigation."
> [R. 151-152.]

The revenue authorities never availed themselves of the right to file a new application, but instead elected to file the instant appeal.

**Admitted Historical Facts, 1916 to 1923.**

Chandis was created by Mrs. Chandler's husband, Harry Chandler, in 1916. Forty per cent of its capital stock (200 shares) was issued to Mrs. Chandler and fifty-six per cent (280 shares), in equal proportions, to her eight children [R. 51]. Soon thereafter Mr. Chandler transferred assets to Chandis and received from it interest-bearing (5%) promissory notes which he assigned to Mrs. Chandler and the children in approximately the same proportion as their stockholdings [R. 58]. Interest accrued on December 31, 1923, totaled $702,049.61, of which amount $294,950.76 was due Mrs. Chandler [R. 44]. On December 31, 1923, Chandis issued new notes (augmented by the accrued interest) to Mrs. Chandler and the children [R. 45]. The Commissioner assessed

deficiencies against Mrs. Chandler for the years 1920 to 1923, inclusive, his theory being that she had constructively received interest income. On appeal to the Board of Tax Appeals, the deficiencies were disallowed [R. 58].[3]

These facts have long been known to the Commissioner. In 1924 he made an exhaustive analysis of Chandis' records for the years 1919 to 1923, inclusive [R. 32]. He has been intimately familiar with the accrual of interest by Chandis from the date of execution of the notes to December 31, 1923, when the new notes, with accrued interest, were executed [R. 58-60].

**Admitted Historical Facts, 1924 to Date.**

Chandis was unable to pay any interest on the new notes, although it accrued the same on its books, as permitted by law, and deducted the same in determining its net taxable income. The amount accrued between January 1, 1924, and December 31, 1929, aggregated $875,008.67, of which $366,418.80 was owed Mrs. Chandler [R. 45]. During the latter part of 1929, pursuant to corporate proceedings duly taken and by virtue of a permit issued by the California Corporation Commissioner, Chandis increased its capitalization and was authorized to issue new stock, at a ratio of ten new shares for one old share, and to cancel its indebtedness to the note holders by issuing additional stock at the rate of one share for each $100.00 of indebtedness [R. 45-47]. The Corporation Commissioner's permit required that cancellation of the notes and issuance of the stock be done

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[3]*Chandler v. Commissioner,* 16 B.T.A. 1248 (promulgated June, 1929).

concurrently, and that new stock not be issued until the notes were cancelled [R. 56-57]. After the exchange was completed, Mrs. Chandler owned 16,721 shares, having received 2,000 shares in exchange for her 200 old shares and 14,721 new shares in cancellation of Chandis' indebtedness to her [R. 47]. As a result of this transaction, the Commissioner in July, 1932, levied an additional assessment against Mrs. Chandler on the theory that all accrued interest (from the inception of the notes in 1916), as represented by the new stock, constituted interest income for the year 1929, in the amount of $661,369.56 [R. 67-72]. Thereupon Mrs. Chandler appealed to the Board of Tax Appeals [R. 165].

The foregoing facts were stipulated to be true by the Commissioner at the time of the hearing of the appeal [R. 28, 43-47]. The Board of Tax Appeals found that the notes were cancelled January 2, 1930, that the new stock was issued as of that date, and that

> "The books of the company contain appropriate entries to show that the transactions were consummated in 1930."
>
> [R. 55.]

Because of this finding, the deficiencies for the year 1929 were disallowed, the Board declaring that if income had been received, it was not until 1930[4] [R. 57]. This court affirmed the decision of the Board.[5]

In 1929 the Commissioner made an exhaustive analysis of Chandis' records for the years 1924 to 1927, inclusive

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[4]*Chandler, et al. v. Commissioner,* 32 B.T.A. 720 (promulgated June, 1935).

[5]*Commissioner v. Chandler,* 89 F. (2d) 332 (decided April, 1937).

[R. 32], and thereafter made final determinations of deficiencies for these years, from which Mrs. Chandler appealed to the Board of Tax Appeals [R. 139]; subsequently he made an examination for the year 1928 [R. 32]. In 1932 the Board, pursuant to written stipulations executed by the Commissioner and Mrs. Chandler, entered orders determining no deficiencies for each of the years 1924 to 1927 [R. 140]. At about the same time the Commissioner withdrew a proposed assessment for the year 1928 [R. 139-140]. The Revenue Agent in charge advised Chandis that its returns for the years 1929 and 1930 would be recommended for acceptance, and at no time has any notice of action contrary to this recommendation been given [R. 32-33].

At the hearing before the Board of Tax Appeals involving Mrs. Chandler's and the children's deficiencies for 1929, there were introduced in evidence the stock certificate book of Chandis, the notes held by Mrs. Chandler and the children which they exchanged for stock, photostatic copies of the new stock certificates and original book entries of Chandis relating to the issuance of the stock [R. 30, 222-237]. Copies at that time were furnished the Commissioner's representative [R. 30]. Pursuant to stipulation there were introduced two copies of the corporate minutes relating to the exchange of notes for stock [R. 29]. There was also introduced the balance sheet of Chandis dated December 31, 1929, which showed the notes still outstanding and that the capital stock increase had not as yet been effected [R. 229]. This

balance sheet was a part of Chandis' 1929 income tax return filed on March 15, 1930, and it, too, reflected the notes as still outstanding and the original capital stock liability as of December 31, 1929 [R. 240-241].

Additional persuasive evidence illustrating the detailed knowledge that the Commissioner has respecting accrual of interest by Chandis on these notes and the exchange of new stock for cancellation of the notes will be found in admissions in the Commissioner's answer to Mrs. Chandler's amended petition before the Board of Tax Appeals [R. 165-176]. The Commissioner expressly admitted that on Mrs. Chandler's notes interest had accrued to December 31, 1929, in the amount of $661,369.56 [R. 174].

The undisputed testimony of appellee Downing before the Board of Tax Appeals clearly and fully recites the manner in which the exchange of stock for notes was accomplished [R. 176-195].

**Appellant's Concession.**

Appellant concedes that the statute of limitations[6] precludes him from sustaining a deficiency against Mrs. Chandler for income received in 1930, in the absence of proof of fraud (2d Br. 48), and that in order to be entitled to make the investigation which he is here attempting, he must establish reasonable grounds for a suspicion that fraud existed (2d Br. 54). The authorities so hold.[7]

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[6]Sec. 275(a) of the *Revenue Act of 1928:* "The amount of income taxes imposed by this title shall be assessed within two years after the return was filed * * *."

[7]*Farmers' & Mechanics' National Bank v. United States,* 11 F. (2d) 348 (C.C.A. 3); *In re Andrews' Tax Liability,* 18 F. Supp. 804 (D.C. Md.); *In re Brooklyn Pawnbrokers, Inc.,* 39 F. Supp. 304 (D.C.N.Y.); *Matter of Morris & Cummings Dredging Co.,* 9 A.F.T.R. 1665 (D.C.N.Y.).

# ARGUMENT.

## Summary of the Argument.

POINT I. JURISDICTION OF THE DISTRICT COURT TO ISSUE THE "ORDER FOR PRODUCTION OF RECORDS" OF MARCH 5, 1940, AND OF THIS COURT TO ENTERTAIN THE PENDING APPEAL, IS DOUBTFUL.

POINT II. THERE HAS BEEN NO SUFFICIENT SHOWING OF REASONABLE GROUND FOR SUSPICION OF FRAUD OR PROBABLE CAUSE FOR SUSPICION THEREOF TO JUSTIFY A REEXAMINATION OF APPELLEE CHANDIS' RECORDS.

POINT III. THE SUBPOENA IS UNREASONABLE AND OPPRESSIVE; IT IS UNLIMITED IN SCOPE AND LACKING IN PARTICULARITY AND IT EMBRACES AN EXCESSIVE PERIOD OF TIME; IF ENFORCED IT WOULD CONSTITUTE AN UNREASONABLE SEARCH AND SEIZURE OF APPELLEE CHANDIS' RECORDS IN VIOLATION OF THE FOURTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES AND AN ABUSE OF THE PROCESS OF THE COURT.

POINT IV. CHANDIS, THE POSSESSOR AND OWNER OF THE DOCUMENTS SUBPOENAED, IS ENTITLED TO CHALLENGE THE VALIDITY OF THE SUBPOENA DUCES TECUM.

## POINT I.

### Jurisdiction of the District Court to Issue the "Order for Production of Records" of March 5, 1940, and of This Court to Entertain the Pending Appeal, Is Doubtful.

**District Court Order for Production of Records** [R. 13].

Jurisdiction of the District Court is considered by the Second Brief for Appellant (pp. 2-4, 29-32). Reliance is had upon *Internal Revenue Code* Secs. 3614 and 3740.

The language of Sec. 3633 (*ante,* p. 2, footnote 1) appears to be sufficiently definite to authorize the District Court in issuing process to compel attendance and production of documents if the jurisdictional facts specified in Sec. 3614 are first made to appear. Certainly the appearance of jurisdictional facts is not conspicuous.

Sec. 3614(a) provides:

> "The Commissioner, for the purpose of ascertaining the correctness of any return * * *, is authorized, * * *, to examine any books, * * * and may require the attendance of the person rendering the return * * *, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter *required by law to be included in such return,* * * *."
>
> *Internal Revenue Code,* Sec. 3614(a).

In the Second Brief for Appellant (pp. 2-4), under the title "Jurisdiction of District Court", there is no statement that in the return of Marian Otis Chandler for the year 1930 any "matter required by law to be included in

such return" was omitted. Elsewhere in appellant's Second Brief we do not observe statement to that effect.

If the record discloses that "the matter required by law to be included in such return" was omitted therefrom, it would appear that the District Court had jurisdiction under Sec. 3633 to issue the Order of March 5, 1940 [R. 13]. We find in the Second Brief for Appellant no specific identification of the "matter required by law to be included in such return" *which was omitted* therefrom.

Appellant's failure to mention the item is difficult of understanding in view of the prominence given the problem in the Order of the District Court, viz:

> "The order is quashed and annulled without prejudice, however, to a new application upon a new petition and a proper showing limited in point of time and *'to matters required to be included in the return'* of Marian Otis Chandler, with special reference to the particular transaction which is under investigation."
>
> [R. 157.]

**Jurisdiction of This Court.**

Second Brief for Appellant (pp. 5 and 6) is given over to a consideration of the jurisdiction of this court. The only authority cited (bottom p. 6) is Sec. 128(a) (*ante,* p. 2, footnoe 2) of the *Judicial Code.* The language of the code provision is simple. Its interpretation, when applied to orders of court, is occasionally difficult. If the Minute Order of the District Court of June 10, 1940

[R. 151], quashing the Order for Production of Records of March 5, 1940 [R. 13], is a "final decision" within the meaning of Sec. 128(a) of the *Judicial Code,* this court would appear to have appellate jurisdiction; otherwise not. Appellant argues the question in his Second Brief (pp. 33-39). Appellant there cites as authority:

Sec. 128(a) of the *Judicial Code;*

*Ex parte Norton,* 108 U. S. 237, 242;

*Bray v. Staples,* 180 F. 321, 330;

*City of Eau Claire v. Payson,* 107 F. 552, 557;

*Potter v. Beal,* 50 F. 860.

In the excerpts quoted by appellant from the opinions in these four cases, nothing more definite is announced than that a decree is final when nothing remains but to enforce execution; that a decision is final when the full measure of the rights of the parties is determined; that a reasonable construction should be given the term "final decree", and that the name applied to the decree does not determine its finality.

The position of appellant is summarized (2d Br. 38) as follows:

> "We submit as a matter of logic, common sense and practical interpretation of both the letter and the spirit of the new rules governing federal district court procedure that this order and judgment was a final decision by the District Court for the purpose of an appeal therefrom to this Court under the provisions of Section 128(a) of the Judicial Code, as amended."

Counsel for appellant may be correct in this statement. If in support of the statement counsel had cited authorities interpreting "the new rules", such opinions undoubtedly would have been helpful. We should have read with interest and instruction appellant's analysis of the opinion of this court in

> *Palmuth et al. v. United States,* 107 F. (2d) 975 (aff'd *Cobbledick v. United States,* 309 U. S. 323).

In the *Palmuth-Cobbledick* case the appeal was from an order denying motion to quash subpoenas *duces tecum* issued out of the District Court directing attendance upon and production of documents before a federal grand jury. The factual difference between that case and the one at bar is the single circumstance that here the order of the District Court required attendance and production of documents before an Internal Revenue Agent conducting a proceeding "in the matter of the taxpayer's 1930 income tax liability" (2d Br. 4). If that factual difference confers jurisdiction in the case at bar, then (assuming jurisdiction in the District Court in the first instance) jurisdiction of the present appeal appears; otherwise not. From the opinion of this court in the *Palmuth-Cobbledick* case, we quote:

> "Appellants have not brought or had occasion to bring any suit or proceeding to recover their papers. *The denial of motions to quash the subpoenas was not a dismissal of any suit or proceeding.* Appel-

lants may, notwithstanding such denial, disregard the subpoenas and, if prosecuted for contempt, may again challenge their validity—thus, in effect, renewing the motions to quash—and, if convicted, may appeal. Upon such appeals, and not otherwise, the denial of the motions may be reviewed by this court."

107 F. (2d) 976.

There is language in the opinion of the Supreme Court in the *Cobbledick case* which may justify, if not compel, the conclusion that the factual difference just previously mentioned confers jurisdiction in the case at bar. We quote:

"Appeal from an order under Sec. 12 was again here in the Ellis case, *supra* [237 U. S. 434, 59 L. Ed. 1036, 35 S. Ct. 645], fully argued in the briefs, and again differentiated from a situation like that in the Alexander case. 'No doubt' was felt that an appeal lay from the district court's direction to testify. *'It is the end of a proceeding begun against the witness'*—was the pithy expression for this type of case. 237 U. S. at 442 [59 L. Ed. 1040, 35 S. Ct. 645]. *And it is a sufficient justification for treating these controversies differently from those arising out of court proceedings unrelated to any administrative agency.* The doctrine of finality is a phase of the distribution of authority within the judicial hierarchy. *But a proceeding like that under Sec. 12 of the Interstate Commerce Act may be deemed self-contained, so far as the judiciary is con-*

*cerned—as much so as an independent suit in equity in which appeal will lie from an injunction without the necessity of waiting for disobedience.* After the court has ordered a recusant witness to testify before the Commission, there remains nothing for it to do. Not only is this true with respect to the particular witness whose testimony is sought; *there is not, as in the case of a grand jury or trial, any further judicial inquiry which would be halted were the offending witness permitted to appeal.* The proceeding before the district court is not ancillary to any judicial proceeding. So far as the court is concerned, it is complete in itself."

309 U. S. 323, 329-330.

See also:

*McCrone v. United States,* 307 U. S. 61, 63;

*Brownson v. United States,* 32 F. (2d) 844, 846 (C. C. A. 8);

*Pacific Mills v. Kenefick,* 99 F. (2d) 188 (C. C. A. 1);

*Farmers' & Mechanics' National Bank v. United States,* 11 F. (2d) 348 (C. C. A. 3);

*Cf: Lowell Sun Co. v. Fleming,* 120 F. (2d) 213, 214 (C. C. A. 1), (aff'd *Holland v. Lowell Sun Co.,* 314 U. S. ....., 62 S. Ct. 793).

Because of comments made during previous oral argument, we felt it our duty to submit the foregoing discussion of jurisdiction.

## POINT II.

### There Has Been No Sufficient Showing of Reasonable Ground for Suspicion of Fraud or Probable Cause for Suspicion Thereof to Justify a Reexamination of Appellee Chandis' Records.

### Analysis of Appellant's Alleged Grounds for Suspicion of Fraud.

**Petition for Production of Records and Affidavits in Support Thereof** [R. 2.].

The petition to the District Court asserts no fraud; it states only that Mrs. Chandler's 1930 return is under investigation [R. 4].

1. *Agent Williams' Affidavit.*

Revenue Agent Williams' affidavit of March 4, 1940 (Ex. C to the petition), contains the affiant's conclusion that examination of Chandis' old records is necessary to determine whether Mrs. Chandler "committed a fraud by failing to report" the receipt of asserted interest income in 1930 [R. 13].

The foregoing comprises the showing made by petitioner upon his *ex parte* application for issuance of the subpoena. After the filing of appellees' Notice of Motion to Quash, appellant filed the following additional affidavits:

2. *Agent Donnally's Affidavit* [R. 73].

Revenue Agent Donnally's affidavit of April 5, 1940, states that appellee Downing in September, 1931, told him the notes were cancelled in 1929, and that he relied upon this "misrepresentation" in making his recommendation that the exchange constituted a taxable transaction in 1929

[R. 74-76]. Downing unequivocally denied Agent Donnally's statement [R. 136]. Regarding this claimed misrepresentation, the District Judge declared:

> "Assuming the truth of the statement, there is no allegation that it was made fraudulently or with intent to conceal any facts or to deceive the government into inaction beyond the period of limitation.
>
> "If it was a mere mistake, it could not amount to fraud or give rise to suspicion of fraud."[8]
>
> [R. 155]

Never until subsequent to filing the Motion to Quash had Agent Donnally contended he had been misled by Downing. That Agent Donnally could not have been misled is persuasively shown by the following written data:

a. Chandis' balance sheet attached to its 1929 return, filed March 15, 1930, and reviewed April 12, 1932 [R. 240], showed that at the end of the tax year unsecured notes were outstanding in the amount of $3,515,606.88, and that the capital stock liability was the same as in previous years [R. 241].

b. Mrs. Chandler's 1929 return was filed the same day as Chandis' 1929 return [R. 100]; both were filed in the Los Angeles office and both were subject to further consideration by the Los Angeles office during the month of October, 1930, as indicated by the endorsement stamp on the face of the returns [R. 100, 240]; Donnally has been assigned to the Los Angeles office *since 1920* [R. 73-74]. Donnally's report of

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[8]Citing *Southern Development Co. v. Silva*, 125 U.S. 247, 250; *Readinger v. Rorick*, 92 F. (2d) 140, 145 (C.C.A. 6); *Roosevelt v. Missouri Life Ins. Co.*, 78 F. (2d) 752, 757 (C.C.A. 8); the rule is stated in Paul and Mertens' *Law of Federal Income Taxation*, p. 418, as follows: "Generally speaking there must be an *intent* to mislead or defraud."

November, 1931, on Mrs. Chandler's 1929 return recites that "all interest items have been checked" [R. 82-85]; Donnally examined Chandis' records and its 1929 income tax return at the time he examined Mrs. Chandler's 1929 return and verified the interest items [R. 137-138].

c. Mrs. Chandler's Supplemental Protest of the proposed 1929 deficiency *(which the Government received one year prior to the running of the statute of limitations on Mrs. Chandler's 1930 return)* expressly stated that she and the children were on December 31, 1929, the owners of notes which, with principal and interest, had a face value of $3,515,606.88 [R. 90-91].

d. In Mrs. Chandler's original Petition for Redetermination filed prior to October 20, 1932 [R. 21],[9] she states on three occasions that interest had accrued to *December 31, 1929,* in the amount of $661,369.56 [R. 7, 8, 11].[9]

e. During the hearing before the Board of Tax Appeals involving the 1929 deficiency, Downing testified that he had not told Donnally the notes were cancelled in 1929—*Donnally was present at this hearing* when Downing so testified—but Donnally sat mute and did not take the stand to deny Downing's testimony! [R. 137]

Agent Donnally is an able and experienced government accountant. He would not have relied on oral statements concerning "interest income" exceeding $600,000.00. He

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[9]These record references are to the Transcript of Record in Case No. 8262, *Commissioner of Internal Revenue v. Marian Otis Chandler* (C.C. A. 9); in the interest of economy the original petition was not printed, but it is part of the certified record.

would have examined the written records which were readily accessible and with which he was familiar.

3. *Agent Williams' Affidavit* [R. 76].

Agent Williams' affidavit of April 6, 1940, does not aver any grounds for suspicion of fraud. It states that the examination is necessary to determine:

(1) How much interest Mrs. Chandler should have reported, and

(2) The value of the stock she received.

Aside from the fact that these desires do not constitute a showing of grounds for suspicion of fraud, the historical background definitely refutes the reasons assigned.

**Amount of Interest Accrued on Mrs. Chandler's Notes Long Known to Commissioner.**

For years the Commissioner has known the amount of interest which had accrued on Mrs. Chandler's notes.[10] He had from year to year levied deficiencies based upon these annual interest items, and in April, 1932, advised Mrs. Chandler that the deficiencies for all prior years had been aggregated and assessed against her for 1929; he stated the amount of interest received from Chandis to be $661,369.56 [R. 93-94]. In the Statement attached to his Letter of Final Determination, dated July 1, 1932, he again stated that Mrs. Chandler received interest income in the amount of $661,369.56 [R. 69]. The stipulation

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[10]In Second Brief for Appellant counsel states on six occasions that the amount accrued on Mrs. Chandler's notes was $661,369.56 (2d Br., pp. 10-11, 14, 46, 49, 60.)

executed by the Commissioner at the time of the 1929 deficiency hearing recites that interest received by Mrs. Chandler was in the same amount [R. 44-45].

The opinion of the Board of Tax Appeals also finds this sum as the amount of interest accruing on the notes owned by Mrs. Chandler [R. 51-52].

**The Commissioner Has Stipulated to the Value of the Stock Received in Exchange for the Notes.**

The assertion that examination is necessary to determine the value of the stock is equally lacking in persuasiveness. In 1932 the Internal Revenue Agent advised Mrs. Chandler that the value of the stock would be considered "as equivalent to the total amount of the interest" [R. 92]. Appellant points out (2d Br. 11) that during the hearing on the 1929 deficiency, the Commissioner and Mrs. Chandler stipulated the value of the stock to be $60.00 per share[11] [R. 177], and the Board so found [R. 55-56]. In view of this stipulation, and in view of the right of the Commissioner to assume that the stock is equal to its par value, it is apparent that the true reason for desiring the examination is not to determine the value of the stock.

4. *Agent Donnally's Affidavit* [R. 141].

Agent Donnally's affidavit of May 2, 1940, contains no averments relating to fraud or suspicion thereof.

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[11]Based on this value, the taxable gain, if any, would have been $72,546.91 (value of stock, $883,233.97, less cost of notes $810,687.06); taxable at 12½% (Sec. 101(a), Revenue Act 1928).

5. *Agent Williams' Affidavit* [R. 148].

Agent Williams' affidavit of May 9, 1940, consists principally of references to sections of the Revenue Act and some legal conclusions. He states that the Internal Revenue authorities "have a strong suspicion" that Mrs. Chandler's failure to report the interest income was due to fraud [R. 149], but avers no facts in this respect. Although in previous years Mrs. Chandler had never reported the interest as income, the Commissioner had never charged her with fraud. He did not charge her with fraud in 1929, although she had not reported the interest as income. Now for the first time he makes this untimely assertion, but gives no facts remotely tending to substantiate it when viewed in their context of admitted prior events.

**Mrs. Chandler Believed, in Good Faith, That Her Acquisition of Stock Did Not Result in Income.**

Prior to the reorganization of Chandis and the exchange of new stock in payment of the notes, Chandis' fiscal officer consulted income tax advisers of recognized standing and was informed that the contemplated transaction would not result in gain or loss to Chandis or the persons to whom the new stock was to be issued [R. 35-36], and Mrs. Chandler in her Protest [R. 88] informed the Revenue Agent and the Commissioner of her belief that the exchange was nontaxable. It is immaterial, so far as fraud is concerned, whether the opinion of the income tax counselors was correct. Failure to report as income property which a taxpayer in good faith does not consider

income and concerning which the law is not settled is no indicia of fraud.

> "It is not inconsistent with good faith that the taxpayer, being ignorant of the regulations and the law generally, sought expert advice and relied upon it. He was not bound to determine a doubtful question against himself, and, in the last analysis, there was no actual concealment. *The returns were all filed on the same day with the same official.*"
>
> *Jemison v. Commissioner,* 45 F. (2d) 4, 6 (C. C. A. 5).

Accord:

> *Rogers Recreation Co. v. Commissioner,* 103 F. (2d) 780, 783 (C. C. A. 2).

In 1935 the Board of Tax Appeals held that an exchange such as here involved was a tax-free exchange under Sec. 112(b)(3) of the Revenue Act of 1928 and resulted in neither taxable gain nor loss.[12] The facts were that the taxpayer and his brother owned in equal parts all but two shares of the capital stock of a family corporation, and they, together with their wives, held notes issued by the family corporation. The taxpayer exchanged the notes for new stock in the corporation. The holding was that the taxpayer was not entitled to take as a loss the difference between the unpaid principal on the notes and the agreed value of the new stock as of the date of the exchange. The Commissioner acquiesced in this decision

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[12]*Burnham v. Commissioner,* 33 B.T.A. 147; affirmed 86 F. (2d) 776 (C.C.A. 7), certiorari denied 300 U.S. 683.

[R. 31].[13] If the Commissioner believed that the *Burnham decision* was correct, how can he consistently say that he suspects Mrs. Chandler guilty of fraud because of not reporting as income the value of stock received in exchange for cancellation of her notes?

Mrs. Chandler's Protest, her Supplemental Protest, and her Amended Petition for Redetermination of the 1929 deficiency all asserted that the recapitalization of Chandis and exchange of notes for stock constituted a nontaxable exchange in connection with a reorganization within the purview of Sec. 112(b)(3), Sec. 112(b)(5) and Sec. 112(i)(1) of the *Revenue Act of 1928* [R. 88, 91, 95, 166].[14]

**District Court Held No Showing of Probable Cause of Suspicion of Fraud.**

The District Court concluded that appellant had failed to show reasonable grounds for suspicion of fraud, saying:

> "The petition and affidavits do not state facts 'showing reasonable grounds of suspicion or probable cause for the examination to ascertain if there has been fraud' * * *.
>
> "Neither the affidavit of Agent Warner E. Williams * * * nor the affidavits of Agent Charles

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[13] *Cumulative Bulletin* 1937-2, p. 281, July to December rulings, Ct. D. No. 1245.

[14] Sec. 112(b) (3) *Revenue Act of 1928:* "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation * * *."

Sec. 112(b) (5): "No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation * * *."

Sec. 112(i) (1): "The term 'reorganization' means * * * (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected."

> W. Donnally * * * nor the affidavit and exhibits filed with the petition allege facts sufficient to show grounds of suspicion or of probable cause for fraud."
>
> [R. 155.]

We have heretofore (*ante,* pp. 16 to 22) analyzed in detail and commented upon appellant's petition and affidavits. They fall far short of a showing of reasonable grounds for suspicion of fraud or probable cause for suspicion thereof.

"Mere affirmance of belief or suspicion" of the existence of fraud will not justify the issuance of a subpoena *duces tecum,* which in scope and effect amounts to a general search warrant.

*Nathanson v. United States,* 290 U. S. 41, 47.

In *Matter of Andrews' Tax Liability,* 18 F. Supp. 804 (D. C. Md.), reexamination of a taxpayer's books for 1931, subsequent to the running of the statute of limitations, was not permitted because the Commissioner had made no showing of reasonable ground of suspicion of fraud or probable cause of fraud with respect to the year 1931.

In *Zimmermann v. Wilson,* 81 F. (2d) 847 (C. C. A. 3), an attempted reexamination of records after the statute of limitations had run was enjoined because the revenue authorities had failed to make any claim or showing of fraud on the part of the taxpayer.

In *Matter of Morris & Cummings Dredging Co.,* an unreported decision[15] of the District Court, Southern Dis-

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[15]The opinion will be found in 9 *American Federal Tax Reports,* 1665.

trict of New York, the Internal Revenue Agent sought to examine documents relating to the taxpayer's liability for 1916 taxes. The government's application was made in 1930, although the taxpayer had filed its return in 1917. The statute of limitations had run. The District Judge proceeded in the same manner as did the District Court at bar. An *ex parte* order for production of the records had been made, but a motion to vacate the order was granted, the court saying:

> "On the present papers, however, there is no proof of the fraudulent intent which is necessary to remove either the three-year or the five-year period of limitation. It would certainly be unjust to permit the government after fourteen years to examine the taxpayer's officers and inspect its books unless there had been fraud. I will therefore grant this motion, *unless the government presents further proof of the taxpayer's fraud.*"
>
> 9 *A. F. T. R.* 1665-1666.

The recent decision (May, 1941) in *In re Brooklyn Pawnbrokers, Inc.,* 39 F. Supp. 304 (D. C. N. Y.), is squarely in point and aptly states the settled rule. There records covering the tax years 1930 to 1938 were subpoenaed and a motion to vacate made. In granting the motion

> "without prejudice to the right of the government to seek an examination upon setting forth facts affording reasonable basis for a suspicion of fraud"

the court declared:

> "It has become a general rule of practice for the courts to deny the government examinations in connection with tax years as to which the statute of limitations has run, except in fraud cases. * * *

* * * * * * * * *

"In the case at bar, the government's affidavit in support of its examination states only 'that the taxpayer wilfully and fraudulently understated its gross income for the years involved.' This is little more than the statement of a conclusion. Certainly *it is no undue burden to require the government to set forth facts leading it to suspect that there may have been fraud.*"

39 F. Supp. 304-305.

To constitute probable cause, the showing must be

"such that a reasonably discreet and prudent man would be led to believe that there was a commission of the offense charged, * * *."

*Dumbra v. United States,* 268 U. S. 435, 441.

The showing made must be of

"facts—not suspicions, beliefs, or surmises. * * * A mere conclusion is insufficient either in the affidavit or the complaint."

*Wagner v. United States,* 8 F. (2d) 581, 583 (C. C. A. 8).

As pointed out by the trial judge, the only claimed showing of a suspicion of fraud is the belated and contradicted assertion of Agent Donnally that he had been misinformed in 1931 respecting the date of cancellation of the notes, but there was no averment that such statement was made with intent to mislead or defraud the Commissioner [R. 155]. There has been no explanation why the government waited until November 30, 1939, to make its reinvestigation when it knew at least as early as 1933 (at the time of the hearing before the Board of

Tax Appeals) that Mrs. Chandler was contending the transaction occurred in 1930 rather than 1929; in fact, the authorities were so advised in March, 1932, by Mrs. Chandler's Supplemental Protest [R. 90, 91]. Donnally, it will be remembered, attended the hearing before the Board of Tax Appeals and was in court at the time Downing denied that he told Donnally the notes were cancelled in 1929, but Donnally remained mute [R. 137, 142].

The District Judge properly declared that the Revenue Agents were not the sole judges as to the scope of the examination which they desired to conduct [R. 156]. Sec. 3614 of the *Internal Revenue Code*[16] does not give Revenue Agents *carte blanche* authority to reexamine any records which they wish or permit the Commissioner's determination of necessity to be considered conclusive. Sec. 3614 is restricted not only by Sec. 3631,[17] but in itself confines the examination to *"publications, papers, records or memoranda bearing upon the matters required to be included in the return."* Appellant admittedly is not conducting the examination for this reason, but, he says, for the purpose of making a roving investigation to determine, first, how much interest Mrs. Chandler should have reported in her 1930 return and, second, the value of the stock she received [R. 77]. These ostensible reasons, we believe, have previously been shown to be wholly lacking in merit (*ante,* pp. 19 and 20).

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[16]Sec. 3614: "The Commissioner, for the purpose of ascertaining the correctness of any return * * * is authorized * * * to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return * * *."

[17]Sec. 3631: "No taxpayer shall be subjected to unnecessary examinations or investigations * * *."

In *McDonough v. Lambert,* 94 F. (2d) 838 (C. C. A. 1), the court reversed the District Court's denial of a motion to vacate an order granting a subpoena *duces tecum* which required production of documents in connection with the tax liability of the McDonough Company *and others.* The subpoena had been served upon the treasurer of the McDonough Company. The Internal Revenue Agent conceded that none of the documents subpoenaed could affect the tax liability of the corporation (94 F. (2d) 840). The District Court, concluding that the information sought might affect the tax liability of other persons, held the subpoena proper. The Circuit Court of Appeals declared:

> "We do not think the provisions of this section [3614] can be given such a broad construction; that by its terms it is more limited in scope and confined to the procurement of evidence, oral or documentary, *bearing upon matters required by law to be included in a given tax return* * * *."
>
> 94 F. (2d) 841.

In that case the Revenue Agents wanted to know who had received a $10,000.00 fee from the McDonough Company. Here appellant wants to make a search in the hope of uncovering something which may show a tax liability. He has nothing definite in mind, for his brief filed with the trial court declares:

> "An examination of the books, *if* it reveals fraud, may reveal *some device* of tax avoidance * * * and *some ground* for tax liability other than the point raised in the *Burnham* case."
>
> (Memorandum of Points and Authorities in Opposition of [*sic*] Motion to Quash Order for Production of Records, p. 34.)

In *Mays v. Davis,* 7 F. Supp. 596 (D. C. Pa.), a Revenue Agent petitioned the court to compel production of corporate records disclosing names and addresses of beneficiaries under trusts created by will. The petition was denied, the court declaring:

> "The power of the court to make the order desired is limited as specified in said section 618 [now Sec. 3614] 'for the purpose of ascertaining the correctness of any return or for the purpose of making a return * * *.' I am of the opinion that the petition is not authorized by section 618; that *to grant the prayer thereof would be to grant a mere explanatory* [*sic*] *search for information on the part of the petitioner,* and that not being within the law that the petition should be refused. It might be added that the information desired can be procured from returns on file in the office of the collector of internal revenue at Pittsburgh."
>
> 7 F. Supp. 596.

Appellant relies on *Zimmermann v. Wilson,* 105 F. (2d) 583 (C. C. A. 3), but the case does not support him. On the contrary, it rather convincingly demonstrates the correctness of the District Judge's ruling. In the *Zimmermann* case, as the persons complaining of the search did not own the subpoenaed records, it was held they could not invoke the Fourth Amendment. The Revenue Agents restricted their request to stockbrokers' records for three years—1929, 1930, and 1932. Uncontradicted evidence was introduced showing large sales of stock by a husband and purchases of the same stock by his wife on the same day. As a result the husband reported a net loss in excess of $146,000.00 for the year 1929, whereas if the sales

were not allowed, he would have shown a net gain of approximately $271,000.00 (105 F. (2d) 585). The undisputed evidence also showed that the transactions were all conducted by the husband and that *the wife did not know when purchases or sales were made by her.* Under such state of facts, the court held the investigation authorized, but Circuit Judge Biddle warned:

> "If they [revenue agents] attempt to examine unrelated transactions, or to engage in an irrelevant, 'fishing expedition', as complainants suggest, they may be restrained by the court to whom application is made to enforce compliance."
>
> 105 F. (2d) 583, 585.

In the case at bar Mrs. Chandler, in contrast to Mr. Zimmermann, has not taken any deductions as a result of any of her transactions with Chandis. When Mrs. Chandler sells the stock, she may have a taxable gain.[18] The showing made in the *Zimmermann case,* of reasonable grounds for a suspicion of fraud, is by no means similar to that here presented. This is made abundantly clear from a reading of the opinion. If the court desires to make further comparison, we respectfully refer it to pages 45 to 55, 62, 112, 134 to 136, 208 to 211, 231, and 239 to 242, of the Zimmerman Transcript of Record.[19]

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[18] *Revenue Act 1928,* Sec. 113(6): "If the property was acquired upon an exchange described in section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made."

[19] "* * * it is permissible to examine the record resulting in an opinion, to ascertain the grounds upon which the opinion is based." (*Atlantic Fruit Co. v. Red Cross Line,* 5 F. (2d) 218, 219 (C.C.A. 2).)

Appellant also cites (2d. Br. 41) *In re Upham's Income Tax,* 18 F. Supp. 737 (D. C. N. Y.), and *In re Keegan,* 18 F. Supp. 746 (D. C. N. Y.).

In *Upham's case* objection was made to the subpoena on the ground it violated the Fourth Amendment. The court held the objector was not entitled to raise the point as she did not own the documents which were sought (p. 738). But appellee Chandis is the owner and possessor of the subpoenaed documents.

*Keegan's case* did not involve a subpoena *duces tecum*—merely a subpoena *ad testificandum* (pp. 747-748).

Appellant lays frequent stress (2d. Br. 12-13, 20, 46-47, 49) upon the circumstance that Mrs. Chandler's original Protest (December 17, 1931) [R. 87] to the proposed assessment of additional taxes for 1929 contained the assertion that during the calendar year 1929 Chandis had acquired its notes from Mrs. Chandler [R. 88]. It is this statement on which appellant at times seems to rely to show that he has reasonable grounds to suspect fraud, *but no representation was ever made that Mrs. Chandler acquired the new stock during the calendar year 1929.*[20] The statement upon which appellant relies has been removed from its context. When viewed and interpreted in light of the surrounding circumstances, there is no basis for the contention that this statement misled the revenue authorities. In the paragraph immediately following that

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[20]It is acquisition of the stock that would give rise to a taxable gain (unless the exchange were nontaxable)—not the surrender by Mrs. Chandler of her notes.

portion of the Protest upon which appellant places reliance, Mrs. Chandler stated:

> "The Internal Revenue Agent has erroneously included this sum as income which was not paid to the taxpayer and was not credited to her account or unqualifiedly subject to her demand."
>
> [R. 88.]

Does this not mean that the taxpayer was contending that she did not receive taxable income in 1929?

On March 31, 1932, Mrs. Chandler filed a Supplemental Protest (at this time the revenue authorities were still proposing a deficiency only for interest income representing one year's interest), in which she specifically stated:

> "* * * the taxpayer and her children *on December 31, 1929, were the owners of notes* executed by the Chandis Securities Company that had a face value, together with accrued interest, aggregating $3,515,606.88."
>
> [R. 91.]

Immediately following was the statement that the notes had been exchanged for stock, but *there was no assertion that the exchange had taken place in 1929.* Appellant's statement (2d Br. 46) that Mrs. Chandler advised the revenue authorities that she had exchanged her notes for stock in 1929 is erroneous.

Subsequent to receipt of the Supplemental Protest, and on April 4, 1932, the local revenue authorities recomputed Mrs. Chandler's tax and then *for the first time* advised her that all interest which had accrued during the years 1916-1929 would be treated as income received in 1929 [R. 92].

Heretofore the revenue authorities had been proposing a deficiency for merely one year's interest—that of 1929 [R. 80, 82], but at this time they changed their theory and asserted that the interest for all years from 1916 to 1929 had been received in 1929, saying:

> "Consideration has been given to the seeming unfairness of proposing a deficiency for the taxable year while deficiencies for prior years based on the same items were still pending, but it is only by so doing that the matter could be placed in position for a complete settlement of the interest question * * *." [R. 93.]

Appellant suggests (2d Br. 48), although nothing in the record justifies it, that Mrs. Chandler purposely waited until the statute of limitations had run against additional assessment of tax for the year 1930 before filing her amended petition with the Board of Tax Appeals wherein she alleged that if the exchange resulted in taxable income, the income was taxable in 1930—not in 1929. The fact of the matter is, as stated by appellant (2d Br. 48), the amendment was filed upon the suggestion of a new attorney shortly following his association in the case; prior to filing the amendment, the attorney discussed the matter with Mr. Leming, counsel for the Commissioner [R. 201-202]. Actually Mrs. Chandler did not change her theory by filing the Amended Petition for Redetermination wherein she specifically alleged that the transaction occurred in 1930—not in 1929 [R. 167]. In her original

Petition for Redetermination she stated three times that the interest on the notes had accrued to December 31, 1929 [R. 7, 8, 11],[21] in her original Protest she stated that the accrued interest "was not credited to her account or unqualifiedly subject to her demand" [R. 88], and in the Supplemental Protest that she owned the notes on December 31, 1929 [R. 91]. Such statements, we submit, are not susceptible of any interpretation other than that Mrs. Chandler was contending that she had not received income in 1929 as a result of the reorganization of Chandis.

If the revenue authorities had deemed themselves misled or prejudiced by Mrs. Chandler's prior conduct, would not objection to the amendment have been interposed? Would they not have asserted an estoppel[22] to contend that the transaction occurred in 1930 on the ground that the statute had run as to that year? This was not done, the logical explanation being that the revenue authorities were proceeding on the theory that, irrespective of the actual date of cancellation of the notes and issuance of new stock, the arrangement had been legally completed in 1929 [R. 194-196].

And if fraud was suspected, why did the Commissioner wait until 1940 to assert it?

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[21]These record references are to Case No. 8262 as explained (*ante*, p. 18, footnote 9).

[22]If the Commissioner had deemed the government prejudiced by Mrs. Chandler's "change of position," he could with propriety and with success have asserted an estoppel (*Portland Oil Co. v. Commissioner*, 109 F. (2d) 479, 485-486 (C.C.A. 1), certiorari denied 310 U.S. 650).

## POINT III.

**The Subpoena Is Unreasonable and Oppressive; It Is Unlimited in Scope and Lacking in Particularity and It Embraces an Excessive Period of Time; if Enforced It Would Constitute an Unreasonable Search and Seizure of Appellee Chandis' Records in Violation of the Fourth Amendment to the Constitution of the United States and an Abuse of the Process of the Court.**

The District Judge's opinion shows he concluded from the record that the subpoena was unreasonable, for he declared:

> "The petition and affidavits do not show the need for an examination of *all the fiscal records of the corporation*[23] for the years 1916 to 1930, when the only issue involved is the tax liability of one of its stockholders, Marian Otis Chandler, for the year 1930, by reason of a single transaction, *long known to the Government*[23] and to the agents of the Bureau of Internal Revenue."
>
> [R. 155-156.]

The *Fourth Amendment* guarantees all persons against unreasonable searches and seizures.[24] Certain elementary principles concerning this amendment should be briefly stated.

The amendment is to be liberally construed.

*Go-Bart Co. v. United States,* 282 U. S. 344, 357.

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[23]Italics are by the court.

[24]"The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated." (*United States Constitution, Fourth Amendment.*)

It applies to civil[25] as well as criminal proceedings. In *Weeks v. United States,* 232 U. S. 383, 392, the court said of the Amendment:

> "This protection reaches all alike, *whether accused of crime or not,* and the duty of giving to it force and effect is obligatory upon all entrusted under our Federal system with the enforcement of the laws."

It proscribes all process which in effect amounts to a general warrant.

> "All unreasonable searches and seizures are absolutely forbidden by the Fourth Amendment. * * *
>
> "The amendment applies to warrants under any statute; revenue, tariff, and all others."
>
> *Nathanson v. United States,* 290 U. S. 41, 46-47.

In determining the reasonableness or unreasonableness of a subpoena *duces tecum:*[26]

> "Each case is to be decided on its own facts and circumstances."
>
> *Go-Bart Co. v. United States,* 282 U. S. 344, 357.

We have heretofore (*ante,* pp. 4 to 8), pointed out the minute familiarity which the revenue officials have had with the affairs of Mrs. Chandler and Chandis in so far as the reorganization and exchange of stock for notes are concerned. With these facts in mind, and recalling that

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[25]*Cudahy Packing Co. v. United States,* 15 F. (2d) 133, 136-137 (C.C. A. 7); *Federal Trade Commission v. Smith,* 34 F. (2d) 323, 324 (D.C. N.Y.); *Silverthorne Co. v. United States,* 251 U.S. 385, 392.

[26]We treat the Order for Production of Records as being in substance a subpoena *duces tecum* (*Consolidated Rendering Co. v. Vermont,* 207 U.S. 541, 550).

purportedly appellant is seeking only to investigate the 1930 return of Mrs. Chandler, we list the documents sought to be subpoenaed. They consist of Chandis' records for a fifteen-year period (1916 to 1930), and include:

1. Minute Books;
2. Stock Books;
3. All fiscal records;
4. All vouchers, correspondence, and other written data supporting original entries in the accounting books;
5. All promissory notes of Chandis issued to Mrs. Chandler and the children during the fifteen-year period, which have been paid or otherwise cancelled.
   [R. 5.]

Appellant made no effort to restrict his demand to documents pertaining to the 1930 transaction. He not only seeks records concerning Mrs. Chandler, but also those concerning her eight children. There has been no attempt made to show the probable materiality of these ancient and unrelated documents.

The subpoena is unlimited in scope, is lacking in particularity, and embraces an excessive period of time. There are many announcements of the Supreme Court dealing with this matter, and we have included a brief summary of them in the Appendix. Appellant has not seen fit to discuss any of these cases, although they are the decisions commonly relied on by inquisitorial bodies to sustain their subpoenas.

Although there is no precise formula by which the reasonableness of a search may be determined, the closest approach to one is negatively stated in *Wilson v. United States,* 221 U. S. 361, 376:

> "* * * there is no unreasonable search and seizure, when a writ, *suitably specific and properly limited in its scope,* calls for the production of documents which, as against their lawful owner to whom the writ is directed, the party procuring its issuance is entitled to have produced."

Tested by this criterion, the subpoena here under consideration clearly is violative of the constitutional guarantee. It is neither specific nor limited as to subject matter. It commands the production of all fiscal records embracing a period of fifteen years, and is not properly limited as to time, the records sought reaching back a quarter of a century to the creation of the corporation.

All cases cited by appellant (2d Br. 41, 45) recognize that subpoenas *duces tecum* must not conflict with the constitutional guarantee or be used as a roving commission.

In *Zimmermann v. Wilson,* 105 F. (2d) 583, 585 (C. C. A. 3), Circuit Judge Biddle declared:

> "The Fourth Amendment protects against unreasonable searches; and 'the search is "unreasonable" only because it is out of proportion to the end sought'; * * * Agents may not 'under official pretext but in fact officiously, extend their powers beyond those provided by the law. * * *' * * * If they attempt to examine unrelated transactions, or to engage in an irrelevant 'fishing expedition', as complainants suggest, they may be restrained by the court to whom application is made to enforce compliance."

In *McMann v. Engel,* 16 F. Supp. 446, 447-448 (D. C. N. Y.), the court said:

> "* * * a compulsory production of private papers pursuant to subpoena may amount to an unreasonable search and seizure of a person's papers, contrary to the Fourth Amendment. The deciding factor, in last analysis, is the reasonableness of the subpoena. * * * *Where the order for production of papers is the equivalent of a general warrant, the person whose papers are demanded will be given relief by the courts.*"

In *McMann v. Securities and Exchange Commission,* 87 F. (2d) 377, 379 (C. C. A. 2), the court said:

> "No doubt a subpoena may be so onerous as to constitute an unreasonable search. * * * the search is 'unreasonable' only because it is out of proportion to the end sought, as *when the person served is required to fetch all his books at once to an exploratory investigation whose purposes and limits can be determined only as it proceeds.*"

In *United States v. Union Trust Co.,* 13 F. Supp. 286 (D. C. Pa.), the Board of Tax Appeals issued a subpoena *duces tecum* to compel production of corporate minutes for the years 1931 and 1932. The subpoena was issued during the course of a hearing to determine whether a third party had been guilty of fraud. Of one paragraph the court declared:

> "This paragraph is a blanket demand for the production of the minutes of the Union Trust Company for the years 1931 and 1932. Lacking specification as it does, the paragraph is violative of the rights of

## POINT IV.

### Chandis, the Possessor and Owner of the Documents Subpoenaed, Is Entitled to Challenge the Validity of the Subpoena Duces Tecum.

Appellant asserts (2d Br. 55-56) that he is investigating Mrs. Chandler's return—not Chandis' return—and therefore Chandis may not complain of the unreasonableness, untimeliness, or the futility of the subpoena. No authority is cited which supports this contention. If such were the rule, the provisions of the Fourth Amendment against unreasonable searches and seizures might readily be circumvented by purportedly conducting an investigation of the return of one person and seeking in the course thereof to examine documents belonging to another.

In *United States v. Union Trust Co.,* 13 F. Supp. 286 (D. C. Pa.), it was held that the revenue authorities, in attempting to examine records belonging to a corporation during the course of their investigation of the tax return of an individual, were bound by the mandate of the Fourth Amendment.

#### Appellant's Authorities Analyzed and Distinguished.

*Zimmermann v. Wilson,* 105 F. (2d) 583 (C. C. A. 3), held that persons not the owners of documents subpoenaed could not object to their production. This is not that kind of a case.

*In re Upham's Income Tax,* 18 F. Supp. 737 (D. C. N. Y.), is similar to the *Zimmermann case,* the party objecting not being the owner of the records.

*In re Keegan,* 18 F. Supp. 746 (D. C. N. Y.), did not concern a subpoena *duces tecum,* merely one *ad testificandum.*

*Caplis v. Helvering,* 4 F. Supp. 181 (D. C. N. Y.), was a plenary action to restrain the Commissioner from serving a subpoena on the plaintiff in connection with the Commissioner's investigation of the tax liability of a deceased person. *It does not appear that any subpoena duces tecum was involved.* The court held that plaintiff could not claim the Collector had acted in excess of his powers in issuing a summons merely because the statute of limitations had run against the decedent's estate. This principle is not disputed here. *The controlling criterion in a case wherein the Fourth Amendment is properly invoked is whether the subpoena is reasonable.* The circumstance that in the absence of proof of fraud on the part of Mrs. Chandler in her 1930 return, no further tax can be collected from her for that year is a persuasive, and we think a compelling, reason for holding that the attempted search is unreasonable—particularly when viewed in light of the facts and records now in the possession of the revenue authorities, their past familiarity with the single transaction here involved, and the all-embracing scope of the subpoena which the District Judge quashed.

*United States v. American Exchange Irving Trust Co.,* 43 F. (2d) 829 (D. C. N. Y.), and *United States v. First Capital National Bank,* 89 F. (2d) 116 (C. C. A. 8), did not involve the Fourth Amendment. They hold that in distraint proceedings the party distrained (a debtor of the delinquent taxpayer) could not assert that the statute of limitations had run against collection of the tax. These cases are analogous to those holding that a person not the

owner of records sought to be subpoenaed cannot complain of the unreasonableness of the subpoena. In these distraint cases it was no concern of the banks to whom they paid the amounts on deposit. Payment pursuant to law would operate as a discharge of their obligation to their depositors.

Entirely aside from the constitutional guarantee, there are further compelling reasons why Chandis may properly challenge the validity of the subpoena.

**The Investigation Here Sought, Although Ostensibly One Concerning Mrs. Chandler, Is Actually an Investigation in Connection With the Tax Returns of Chandis for the Years 1916 to 1930.**

The practical effect of the subpoena would be to permit the revenue authorities to accomplish by indirection that which cannot be directly done. Appellant is really interested in making this examination in order to look into the returns of Chandis for many years past. The record discloses the following:

> *November 10, 1939*—Appellant serves Chandis with a letter dated *June 15, 1937,* requesting reexamination of its records in connection with its own tax returns for the years 1916 to 1930 [R. 25, 37].
>
> *November 28, 1939*—Chandis advises Commissioner that it will not accede to his request [R. 25, 38].
>
> *November 30, 1939*—Commissioner serves on Mrs. Chandler a letter dated *March 31, 1938,* requesting reexamination of her 1930 return [R. 9, 25]. On this same date, and without waiting for Mrs. Chandler to indicate her compliance or rejection of his request, the

Commissioner (acting through appellant) serves an administrative summons on Chandis in connection with its returns for the years 1916 to 1930 [R. 25, 26, 40], and another administrative summons on Chandis with respect to Mrs. Chandler's 1930 return [R. 4-5, 10].

*December 11, 1939*—Chandis declines to permit Commissioner to examine its records in connection with its tax returns for the fifteen-year period [R. 41].

*March 5, 1940*—Appellant files Petition for Production of Records [R. 13].

The revenue authorities have never notified Chandis of any intention to abandon their examination of its old returns embracing this lengthy period [R. 26].

The foregoing chronology indicates rather persuasively that it is with Chandis' returns that the revenue authorities are in fact concerned—not Mrs. Chandler's return for one year. As pointed out by the District Court,

> "The petition and affidavits do not show the need for an examination of *all the fiscal records of the corporation*[29] for the years 1916 to 1930, when the only issue involved is the tax liability of one of its stockholders, Marian Otis Chandler, for the year 1930, by reason of a single transaction, *long known to the Government*[29] and to the agents of the Bureau of Internal Revenue."
>
> [R. 155-156.]

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[29]Italics are by the court.

The single transaction referred to by the District Court related to the exchange, pursuant to the recapitalization of Chandis, of its new stock for its old stock and notes, plus accrued interest. The purpose of appellant is further emphasized by the following quotation from his brief (2d Br. 61):

> "Chandis has already had the benefit of deductions from its own gross income with respect to the interest transactions between itself and its principal stockholder now under investigation. Surely the Commissioner is now entitled to the aid of the courts in this proceeding where his sole purpose is to enable him to ascertain and determine the real substance and tax consequences of this same long series of interest transactions * * *."

The "tax consequences of this same long series of interest transactions" certainly cannot affect Mrs. Chandler's income tax liability for the year 1930. We have heretofore pointed out to the court that the Board of Tax Appeals for the years 1920 to 1927, inclusive, has long since made final determinations of her "tax consequences of this same long series of interest transactions" (1920 to 1923 [R. 58]; 1923 to 1927 [R. 139-140]). The action of the Commissioner proposing the additional taxes for the year 1928 was abandoned by him when he issued his deficiency letter [R. 67] for the year 1929; and for the year 1929 the Board of Tax Appeals' decision that Mrs. Chandler derived no taxable income during that year has become final. Consequently, the only "tax consequences" that could arise from this "same long series of interest

transactions" would be the tax consequences of Chandis Securities Company. The deductions taken by Chandis of the accrued interest were permitted by Sec. 23(b), Revenue Act of 1928 (*ante,* p. 40, footnote 27).

In view of the foregoing, it is obvious that appellant could not reasonably be interested in the effect upon Mrs. Chandler's return for 1930 of this "same long series of interest transactions."

It was not until after Chandis had declined to submit to reexamination that appellant served a letter on Mrs. Chandler advising her that reexamination would be made, and concurrently therewith served two administrative summonses on Chandis, one relating to its returns (1916-1930), the other to Mrs. Chandler's 1930 return. The nature of the documents required by the summonses further confirms the assertion that it is Chandis—not Mrs. Chandler—that is under investigation. If this were not so, there would clearly be no occasion for seeking examination of records referring to the Chandler children and not to Mrs. Chandler. Appellant has never attempted to explain why the dealings of Chandis with the Chandler children over the fifteen years involved (1916-1930) have any bearing upon matters required to be included in Mrs. Chandler's 1930 return. Nor has appellant ever indicated a desire to make a reexamination relative to the returns of the children [R. 36].

If further evidence is required to convince that it is Chandis—not Mrs. Chandler—that is the object of the attempted investigation, it will be found in the record. The Order for Production of Records [R. 15] calls for documents not included in the administrative summons which appellant served on Chandis in connection with his

Appellant does not assert that any matters required to be included in Mrs. Chandler's 1930 return were omitted. He could not successfully do so in view of the decision in *Burnham v. Commissioner,* 33 B. T. A. 147 (affirmed 86 F. (2d) 776 (C. C. A. 7), certiorari denied 300 U. S. 683), in which decision the Commissioner has acquiesced (*ante,* p. 23). And under the express mandate of the statute, *Revenue Act of 1928,* Sec. 112(3)(5) (*ante,* p. 23), the transaction here involved clearly did not result in any taxable gain or loss. The appellant's authority in this proceeding is conferred by Sec. 3614, and when the person whose records are subjected to subpoena challenges his authority, he is, we submit, required to establish that it exists before he is entitled to proceed.

After appellees challenged the propriety of the investigation, appellant's assistants filed a further affidavit stating that the reason for the investigation is to determine how much interest Mrs. Chandler should have reported and the value of the stock she received [R. 77]. As previously pointed out (*ante,* pp. 19 to 20), these ostensible reasons are lacking in merit for these facts are well known to the Commissioner. But even though Mrs. Chandler should have reported the receipt of the stock in her 1930 return, what bearing would records for fourteen years prior to 1930 and the dealings of Chandis with the Chandler children have upon Mrs. Chandler's return?

A roving inspection, such as is here sought, will not be tolerated, particularly when the tax officials have at their command full information concerning the matter allegedly under investigation.[32]

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[32]This matter has previously been developed (*ante,* pp. 28 and 29).

## Conclusion.

We asserted below without contradiction, and we here reassert, that appellant can cite no decision wherein a search embracing such an unreasonable period of time, so lacking in definiteness and calling for all fiscal records of a corporation, has been sanctioned. The subpoena is the equivalent of a general search warrant, which the Supreme Court has unequivocally condemned (*Boyd v. United States,* 116 U. S. 616, 624-630, 635). Constitutional guarantees must not be sacrificed to expediency.

> "The Fourth Amendment, which prohibits unreasonable searches and seizures, is one of the pillars of liberty so necessary to a free government that expediency in law enforcement must ever yield to the necessity for keeping the principles on which it rests inviolate."
>
> *United States v. 1013 Crates of Whiskey Bottles,* 52 F. (2d) 49, 51 (C. C. A. 2).

The trial court properly concluded that appellant did not make a showing of reasonable grounds or probable cause for suspicion of fraud. Undisputed documentary evidence abundantly establishes the correctness of this conclusion. The order should be affirmed.

Respectfully submitted,

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## APPENDIX.

### Summary of Supreme Court Decisions Establishing Criteria for Determining Reasonableness of a Subpoena Duces Tecum.

*Hale v. Henkel,* 201 U. S. 43 (1906).

The grand jury subpoena required production of:

(1) All understandings, agreements, arrangements or contracts between MacAndrews etc. Co. and six other firms from the date of organization of MacAndrews etc. Co.;

(2) All correspondence between MacAndrews etc. Co. and six other firms;

(3) All reports or accounts from the six firms to MacAndrews etc. Co.;

(4) All letters received by MacAndrews etc. Co. since the date of its organization from thirteen other named companies, and all copies of correspondence with the companies.

The court said:

> "* * * an order for the production of books and papers may constitute an unreasonable search and seizure within the Fourth Amendment. While a search ordinarily implies a quest by an officer of the law, and a seizure contemplates a forcible dispossession of the owner, still, as was held in the *Boyd case,* the substance of the offense is the compulsory production of private papers, whether under a search warrant or a *subpoena duces tecum,* against which the person, be he individual or corporation, is entitled to protection. Applying the test of reasonableness to the present case, we think the *subpoena duces*

*tecum* is far too sweeping in its terms to be regarded as reasonable.

* * * * * * * * *

"* * * A general subpoena of this description is equally indefensible as a search warrant would be if couched in similar terms." (201 U. S. 76, 77.)

*Consolidated Rendering Co. v. Vermont,* 207 U. S. 541 (1908).

A state grand jury, while investigating charges against four persons of selling contaminated meat, issued a subpoena *duces tecum* to produce records from January, 1904, to October, 1906, the date of the notice. The records subpoenaed were confined to transactions with four accused individuals and the cattle commissioners of Vermont (66 Atl. 790; 80 Vt. 55). The court declared:

"The notice also gave in detail the dates and amounts of checks and vouchers which the company was required to produce. * * * We see no reason why all such books, papers and correspondence which related to the subject of inquiry, and were described with reasonable detail, should not be called for and the company directed to produce them. * * * The notice is not nearly so sweeping in its reach as in the case of *Hale v. Henkel,* * * *" (207 U. S. 554.)

*Wilson v. United States,* 221 U. S. 361 (1911).

A federal grand jury had indicted Wilson, President of the United Wireless Telegraph Company. About two months after finding the indictment, it served a subpoena *duces tecum* on Wilson requiring production of

"Letter press copy books of United Wireless Telegraph Company containing copies of letters and tele-

grams signed or purporting to be signed by the President of said Company during the months of May and June, 1909; * * *." (221 U. S. 367 (footnote).)

This subpoena was held not to constitute an unreasonable search and seizure, the court saying:

"But there is no unreasonable search and seizure, when a writ, suitably specific and properly limited in its scope, calls for the production of documents which, as against their lawful owner to whom the writ is directed, the party procuring its issuance is entitled to have produced. In the present case, the process was definite and reasonable in its requirements, and it was not open to the objection made in *Hale v. Henkel,* * * *." (221 U. S. 376.)

The subpoena here only sought documents signed by the person indicted during a two-months period, which period antedated the issuance of the subpoena by eighteen months.

*Wheeler v. United States,* 226 U. S. 478 (1913).

In April, 1912, a federal grand jury was investigating Wheeler and Shaw (Treasurer and President, respectively, of Wheeler & Shaw, a corporation) to determine whether mail frauds had been committed. It issued a subpoena *duces tecum* directed to these men, requiring them to produce

"* * * all the cash books, ledgers, journals and other books of account of the company, and all copies of letters and telegrams of Wheeler & Shaw, Incorporated, whether signed or purporting to be signed by the corporation or by its president or treasurer in